No. 12309

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

WIL-RUD CORPORATION,

Appellant,

vs.

E. A. LYNCH, Receiver and Trustee of the Estate of California Associated Products Co., AARON LEVINSON, VICTOR KRAMER, BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, F. W. BOLTZ CORP., and LEO BRILL,

Appellees.

BRIEF OF E. A. LYNCH, RECEIVER.

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BRIEF OF E. A. LYNCH, RECEIVER.

The controversy before this Court involves the disposition of a petition for leave to compromise a dispute ensuing between the appellant and the Receiver after a judicial sale to the appellant of assets belonging to the bankrupt estate of the California Associated Products Co., which sale was duly confirmed by the Court and the order of confirmation has long since become final [Tr. pp. 12-16; order confirming sale, Tr. pp. 3-7]. The Court is not concerned with the proceedings brought to enforce compliance with this sale, namely, the petition for order to show cause re Wil-Rud Corporation which is found on pages 8 and 9 of the Transcript. No order was ever made on that order to show cause.

Briefly, the history of the controversy is as follows: The proceeding originated in the District Court under Chapter XI of the National Bankruptcy Act on July 29, 1947, and under this Chapter XI proceeding E. A. Lynch was appointed Receiver. The Chapter XI proceedings did not succeed and bankruptcy ultimately resulted on April 26, 1948. Mr. Lynch came into possession of the assets of the bankrupt located at No. 3631 Union Pacific Avenue, Los Angeles, in a plant known as the Yankee Doodle Root Beer Company in the latter part of August. The bankrupt was engaged in this plant in the manufacture and distribution of root beer. An offer was made through Aaron Levinson, a creditor, and a member of the informal Creditors' Committee [Tr. p. 51] to purchase the assets of the Yankee Doodle plant for $135,000.00 at private sale and without competitive bidding [Tr. pp. 29 and 30]. The Court declined to approve this proposal and ordered the property sold at competitive bidding [Tr. p. 30]. The matter came on for hearing before the Referee on October 15, 1947 [Tr. p. 50] and the offer of $135,000.00 was renewed in open Court by Mr. Levinson [Tr. p. 52]. The offer was made on behalf of one Miller and proposed to buy all of the outstanding shares of the Yankee Doodle Root Beer Company, the "physical" assets of the California Associated Products, all trade names, trade-marks, all formulas, and registered trade styles, the lessee's interest in the lease, and expressly excluded merchandise held by the Bank of America as a pledge, and certain items held at Fresno to secure two pledges of firms located there. The offer also excluded cash on hand, accounts or notes receivable, or deposits made by those corporations. No reference was made to inventory. The purchaser proposed to take over the existing insur-

ance on a pro rata basis, title to be delivered to him free and clear except the water softener. A check for $10,000.00 was tendered [Tr. pp. 52 and 53]. The Referee announced that he was going to sell the assets to the highest bidder for the greatest amount of money [Tr. p. 54].

Mr. Katz submitted the second bid in open Court amounting to $137,500.00 [Tr. p. 59]. The bidding went up, Mr. Miller raising it to $140,000.00 [Tr. pp. 59 and 60]. It continued upward, and at page 62 of the transcript Mr. Katz made the statement "Mr. Rudolph bids $146,000.00 on the same basis as the Miller bid excepting only that with respect to the lease he will take whatever right, title, and interest in the estate that the estate can convey to him." After a short recess [Tr. p. 65] the bidding resumed again [Tr. p. 68] and climbed to $161,000.00. The Referee thereupon announced that the assets were sold to the Wil-Rud Corporation for $161,000.00.

Immediately after this announcement, Mr. Gendel, attorney for the Receiver, proceeded to clarify any question as to what was being sold, and the Referee then reiterated his verbal confirmation of the sale with this statement [Tr. p. 71]:

> "This meeting is adjourned. The sale is confirmed for $161,000.00 to Samuel C. Rudolph & Associates, Incorporated, a corporation."

There was no mention of inventory adjustments at any time in the proceedings or during the conduct of the sale.

That the sale was made "as is," appears to be perfectly clear from that part of the statement of Mr. Gendel be-

ginning at the bottom of page 68 of the transcript and continuing on to page 69. Mr. Gendel said:

> "The Receiver is selling machinery, equipment and fixtures located at the place of business of the California Associated Products Co., 3631 Union Pacific Avenue, and the inventory *as is now,* subject only to the balance owing on the water softener of $1699.17."

Further significance of this statement appears in the order confirming the sale [Tr. pp. 4 and 5]. The order confirming the sale confirms the sale to the buyer of all machinery, fixtures, equipment, all inventory, all lessee's improvements, all furnishings, all supplies and unfinished products of every class, character and description whatsoever, located at 3631 Union Pacific Avenue, Los Angeles, California, together with all the other physical assets of the debtor corporation *wheresoever situated,* and together with all of the physical assets of every class and character of the Yankee Doodle Root Beer Co., a corporation, as of October 15, 1947, at *5:00 o'clock P. M.* The day and hour October 15, 1947, at 5:00 o'clock P. M. is again referred to by Mr. Gendel at transcript pages 74 and 75. It is clearly apparent that the assets taken over by the appellant were the assets of the bankrupt as they existed on October 15, 1947 at *5:00 o'clock P. M.* (All italicized matter ours.)

Seven days thereafter, on October 22, 1947, the Referee signed an order confirming and approving the sale, which order was approved by Mr. Katz and Mr. Blum, counsel for appellant. The ten days to review this order of confirmation expired at the latest on November 2, 1947 (Bankruptcy Act, Sec. 39-c). The appellant went into possession of the plant of the bankrupt, taking it over on October 15 at 5:00 P. M., the date of the sale in open

Court [Tr. p. 151]. Appellant had been operating the plant for three months when the controversy that is before this Court came before the Referee [Tr. p. 156, testimony of Wolf Wilder].

It developed after appellant had taken over the plant that there were alleged to be outstanding some 25,000 beverage cases with bottles which were in the hands of storekeepers and retailers of Yankee Doodle Root Beer. On each of these cases of bottles the purchaser had made a bottle charge of 60¢ as indemnity for their return [testimony of Ralph J. Yates, Tr. p. 129]. This charge of 60¢ per case was added to the invoice on which the shipments of root beer were made [Tr. p. 130]. There was no written statement anywhere to the effect that the distributor had a lien on the case or the bottles in the case [Tr. p. 130]. So far as Mr. Yates knew, no claims had ever been filed in the Bankruptcy Court for any of the 60¢ per case deposits by any of the distributors [Tr. p. 131].

When a customer placed an order for additional root beer, the delivery was made by the driver, the bottle charge of 60¢ per case was charged to the customer, and upon the driver bringing back the empty case and bottles to the plant, the customer's account was credited with 60¢ per case [Tr. p. 142]. Mr. Yates testified [Tr. p. 144] that on practically every sale the Receiver made there was a return of empties and a credit per case of 60¢ was made to the customers. On page 145 of the transcript he testified that he knew of no instance where the sum of 60¢ was paid in cash without receipt of an order for new merchandise, and characterized the transaction as being "like exchanging milk bottles." When the customer would put a bottle out, the Receiver would put another

bottle in. The life of these cases and bottles was about twelve times a round trip owing to the customers retaining bottles or cases, the storekeeper being unable to return them to the Receiver or the bankrupt, and the result would be no claim for refund [Tr. p. 145].

After running this business for approximately two weeks, Wil-Rud Corporation, the appellant, declined to pay the last $61,000.00 of its purchase price. On October 31, 1947, the Receiver instituted a summary proceeding before the Referee to compel the appellant to comply with his contract. An order to show cause was issued on October 31, 1947. No answer appears to have been filed hereto, no affirmative defense to the order to show cause was asserted, and no steps were taken by the appellant to rescind the sale which had been confirmed by written order of the Court nine days before. Wil-Rud, the appellant, was still well within the time to take a review of the order of confirmation under Section 39-c of the National Bankruptcy Act or to obtain an extension of time to file such petition for review under the same section which provides that a person aggrieved by an order of a Referee may, within ten days after the entry thereof, or within such extended time as the Court may for cause shown allow, file with the Referee a petition for review. Furthermore, if the appellant felt that it was defrauded or overreached, it could very easily have served a notice of rescission and asked the Court to vacate its order of confirmation. It did none of these things.

The hearing on the order to show cause came on before Referee Dickson on November 7, 1940. Appellant then

contended that it bought the assets free and clear of encumbrances, that there was a shortage of $18,952.16, and then later raised the contention that 25,000 cases of empty bottles were out in the hands of customers and that it should not be required to pay the purchase price which it had agreed upon and which the Court had confirmed. The matter was partially heard [Tr. pp. 72-113, incl.] and the Referee indicated from the bench that he was going to allow a set-off of $18,000.00 [Tr. pp. 110 and 112]. Mr. Katz was to prepare the order covering the proceedings up to this point.

Before this order was prepared, the appellant approached the Receiver with an offer to compromise the matter. The Receiver thereupon caused a petition to be prepared to compromise the matter [Tr. pp. 12-16]. The Referee sent notice to creditors of the proposed compromise, calling a meeting to pass thereon (Bankruptcy Act, Secs. 58-a-3 and 6). The meeting was held on January 29, 1948, four months after appellant had gone into possession of the bankrupt's plant and long after the order of confirmation had become final [Tr. p. 16]. At this hearing a number of creditors appeared either in person or by counsel, namely, Aaron Levinson, F. W. Boltz, Victor Kramer and the Bank of America [Tr. p. 115]. Testimony was taken and objections to confirmation of this compromise were entered in the record by Mr. Levinson on his own behalf as a creditor and on behalf of his client, W. M. Yaffee & Co. The Bank of America, through Mr. Steinmeyer, likewise voted against

confirmation [Tr. p. 165], and Victor Kramer and F. W. Boltz Corporation registered their objections thereto at page 166 of the transcript. The District Court has found that these creditors represented over one-half of the unsecured claims [see Memorandum Opinion of Judge Ben Harrison, Tr. p. 37, the District Judge's Findings of Fact No. 3, Tr. p. 46].

The Referee overruled the expressed disapproval of this majority of creditors and with the exception of one creditor present at the meeting, namely, Yankee Doodle Root Beer Bottling Co. of San Fernando Valley, Inc., which expressed no opinion [Tr. p. 166], no creditor expressed approval of the order confirming this compromise. A petition for review of the Referee's order was taken by Aaron Levinson, Bank of America National Trust & Savings Association, Leo Brill, F. W. Boltz Corp. and Victor Kramer [Tr. p. 25]. The Referee certified the matter to the District Court [Tr. pp. 29-36] and the matter was heard. The appellant here, which was not a formal party to the record before the Referee and was in nowise concerned with the litigation save as it might redound to its benefit, was permitted to file a brief before the District Court on review [Tr. p. 44]. District Judge Ben Harrison reversed the order of the Referee, filing a well written Memorandum Opinion in connection therewith on December 16, 1948 [Tr. p. 37] and thereafter making formal written findings of fact, conclusions of law and order granting petition for review, and reversing the order of Referee approving compromise [Tr. p. 44

et seq.] The Wil-Rud Corporation on June 20, 1949, filed its notice of appeal to this Court.

The Minute Order of Judge Harrison, reversing the Referee, was filed December 16, 1948. Notice of appeal was not filed and served for more than *six months* thereafter [Tr. p. 49]. Judge Harrison's formal findings of fact and conclusions of law were not signed until May 24, 1949.

We believe that this delay would in any event be fatal to appellant's attempted appeal even assuming, but not conceding, that appellant here was a proper party to appeal from an order which involved only the Receiver and protesting creditors.

> *Mutual Building & Loan Association v. King* (C. C. A. Ninth Cir.), 83 F. 2d 798;
>
> *In re Interstate Oil Corporation,* 63 F. 2d 674.

The Receiver, not feeling aggrieved by the District Court's order of reversal which meant $18,500.00 more to the bankrupt estate, did not take an appeal therefrom. The only person challenging the correctness of Judge Harrison's order here is the purchaser. It is attempting to chisel down its purchase price months after the sale to it had been confirmed and become final.

ARGUMENT, POINTS AND AUTHORITIES.

The Receiver submits that this appeal should be dismissed and the judgment of the District Court affirmed for the following reasons:

1. That the appeal was taken too late.

2. That Wil-Rud Corporation was not a party to the litigation before the Referee or the District Court, and is not a proper party appellant here.

3. That the remedy of the appellant was by rescission and not refusal to pay the purchase price.

We shall discuss these three points separately.

The Appeal Has Been Taken Too Late.

The Minute Order of Judge Harrison was signed and filed on December 16, 1948. It incorporated therein a memorandum opinion, the concluding paragraph of which reads as follows:

> "In view of the fact that the petition to compromise, filed after the confirmation of the sale was a collateral attack on the sale, and considering the consequences of such action if permitted, the order of the Referee in approving the compromise is hereby reversed.
>
> "Dated: This 16th day of December, 1948.
>
> BEN HARRISON, Judge."

The appeal in this case was filed on June 24, 1949, six months and five days after Judge Harrison's Minute Order. The fact that a formal order was later written up, signed and filed, did not stop the time to appeal running.

In *Mutual Building & Loan Association v. King,* 83 F. 2d 798, this Court had before it a similar problem. On

a contested adjudication, trial of which was had before a Special Master, exceptions were filed to the Master's Findings. United States District Judge Harry Holzer entered a Minute Order overruling the exceptions to the Master's report, approving the report and dismissing the involuntary petitions and intervening involuntary petitions on file. This Minute Order was made on October 25, 1934. Thereafter, on December 24, 1934, a formal judgment was signed and filed. On January 23, 1935, some of the petitioning creditors petitioned for rehearing. On March 22, 1935, the Court ordered stricken, attempted petitions in intervention filed by other creditors. An appeal was taken to this Court by the petitioning creditors and the question raised as to whether or not the appeal was taken too late. Apparently, at the time of the argument the appellee conceded orally that the Minute Order of October 25, 1934, was not an appealable order because the parties thereafter agreed to a form of dismissal which was approved, signed and filed by the trial judge on December 24, 1934. Additional briefs were filed subsequent to the argument, and appellee in those briefs apparently changed his position and contended that the Minute Order of October 25, 1934, was a final order refusing to adjudicate the appellee a bankrupt, was appealable as such, and that the time for appeal could not be extended by the subsequent entry of the formal order to the same effect. Regarding this contention, Judge Wilbur said:

> "Both these propositions are thoroughly established."

After quoting the Minute Order, the Court went on to say:

> "This is an order refusing an adjudication of bankruptcy (In re Interstate Oil Corporation (C. C.

A.), 63 F. (2d) 674; Hudspeth v. Woods (C. C. A.), 70 F. (2d) 504; Stevens v. Nave-McCord Merc. Co. (C. C. A.), 150 F. 71; In re Bieler (C. C. A.), 295 F. 78), and is appealable under 11 U. S. C. A. §48. The right to appeal could not be revived by subsequent entry of the same order. Hudspeth v. Woods, *supra,* Bonner v. Pottef (C. C. A.), 47 F. (2d) 852. It follows that the denial of the adjudication of bankruptcy had become final before any of the proceedings of which the appellant complains. The appeals were allowed both by this court and the District Court, and therefore are properly before us. The appeals from the order of December 24, 1934, however, are ineffectual for any purpose because the adjudication had become final before that order was entered."

In re Interstate Oil Corporation, 63 F. 2d 674, cited by this Court in the preceding case, the Court said:

"The order of October 5, 1931, was not a judgment refusing to adjudge the defendant a bankrupt from which an appeal may be taken under 11 U. S. C. A. §48(a)(1); considered as an order granting leave to amend the petition by adding a statement of the facts showing insolvency, the appeal could be allowed by this court only (11 U. S. C. A. §47(b)), and in either event the appeal would have to be taken within 30 days of the order (11 U. S. C. A.§§47(c), 48). The appeal from the order of October 5, 1931, is therefore dismissed."

We submit that under Section 25-a of the National Bankruptcy Act the appeal had to be taken within thirty days after written notice to the aggrieved party of the entry of the order, judgment or decree complained of, proof of which notice shall be filed within five days after

service or, if such notice be not served and filed, then within forty days from such entry. There is nothing in the record to indicate notice in writing, so the maximum period in which to take an appeal was forty days. However, the appeal was not taken until six months and five days after the Minute Order, and we submit that the appeal should be dismissed.

The Appellant Wil-Rud Corporation Is Not a Proper Party Appellant Here and Should Not Be Recognized as Such by This Court.

In the Court below, Wil-Rud made an offer to the Receiver to compromise the dispute between it and the Receiver, which had reached an acute stage and had resulted in an order to show cause against Wil-Rud why it should not pay the balance of the purchase price forthwith. Whether this offer of compromise was made in writing or was verbal does not appear in the record. At least it is in nowise incorporated into the pleadings. Indeed, it would appear from the Receiver's petition for leave to compromise [allegation No. 3, Tr. p. 13] that the compromise was oral in nature. We quote:

> 'That after a full and complete interchange of facts, your petitioner and his counsel have conferred with the purchaser and its counsel in an effort to determine whether or not a compromise and settlement could be reached so that the administration of the within estate could be brought to a termination; that after negotiations and conferences, the following compromise and settlement has been offered by the purchaser, and is now being recommended to this Court by your petitioner as apparently being for the best interests of the within estate, subject to the approval of this Court."

This petition to compromise which was dated December 26, 1947, was signed by E. A. Lynch, as Receiver, and by Gendel & Chichester, the Receiver's attorneys. It was approved by Charles J. Katz, attorney for Wil-Rud, and was verified by Mr. Lynch. Submission of this compromise was not made by the appellant here but was made by the Receiver. At the hearing thereon on January 29, 1948, the objecting creditors appeared in person and by their respective counsel pursuant to the notice of hearing thereon (Bankruptcy Act, Sec. 58-a-6). They were unquestionably parties to the record as creditors and had an unqualified right to be heard. Otherwise, the provision under Section 58 for notice to creditors would be nothing but a mockery if notice to creditors were to be sent and still creditors have no standing to be heard. On the other hand, Wil-Rud's rights extended only to submitting its offer to the Receiver and having the Receiver submit the same to the Court on due notice to creditors and to have the same considered by the Court and creditors. This was done and the Court and the protesting creditors found themselves at loggerheads. The creditors whose money was being compromised did not like the compromise and expressed themselves in no uncertain terms. The Referee on the other hand, felt that the compromise should be confirmed, and over the protests of these five objecting creditors, confirmed the proposed compromise. The creditors as parties in interest thereupon took a review with the Receiver as respondent on review and not Wil-Rud. The District Court, considering the fact that Wil-Rud had obtained this plant, had operated it for several months and had not sought to rescind its purchase, but had sought to chisel the Receiver down on the purchase price, reversed the order of the Referee.

Wil-Rud has now taken an appeal joining the Receiver as a party appellee.

In the *Matter of Inter-City Trust Company,* alleged bankrupt, 295 Fed. 495, the Court of Appeals for the First Circuit, in holding that a petition to revise was brought too late, being six months after the order complained of, said:

> "Etherington filed on February 26, 1923, a motion to dismiss on the ground that the Inter-City Trust Company was not within the scope of the Bankruptcy Act. This pleading was, on the motion of the petitioning creditors, struck from the record. Etherington is a stranger to these proceedings. His rights, if any, cannot be brought before this court by other creditors."

In the *Matter of Rose,* 86 F. 2d 69, the bankrupt sought to appeal from an order affecting the Conciliation Commissioner under a Section 75 case. The Court said:

> "The conciliation commissioner thereafter on September 30, 1935, filed his petition in the court below, praying that appellee bank and all of its officers and agents be restrained from proceeding with the action to quiet title, and that the receiver appointed by the state court be enjoined from interfering with the property. Appellant did not join in the petition. To this petition appellee bank, its attorneys, and the receiver appointed by the state court filed a demurrer, which on December 13, 1935, was sustained without leave to amend, on the ground that the act as amended on August 28, 1935, was unconstitutional and void.
>
> "This appeal was taken by the bankrupt, the conciliation commissioner not being a party to the appeal. * * *

"Appellees contend that appellant has no standing before this court, because she was not a party to the petition in the trial court, but cites no authorities therefor. *Amicus curiae* contends that appellant 'was not only a party to record but she was obviously the real party in interest in the court below and is still the real party in interest in the present appeal.' * * *

"The filing of the petition by appellant was the equivalent of an adjudication in bankruptcy. Wilkerson v. Cooch (C. C. A. 9th Cir.), 29 Am. B. R. (N. S.) 384, 78 F. (2d) 311, 312.

"*Amicus curiae* apparently contends that, because appellant filed the petition, she was a party to all collateral proceedings which might arise in the main proceeding. If that is the contention, it is untenable, because many issues arise in the administration of a bankrupt's estate, in which the bankrupt cannot even remotely be interested, for example, controversies between the trustee and the creditors.

"We are not here deciding whether or not appellant was 'the real party in interest' so that she could file a petition like the one before us. The question before us is whether the bankrupt had a right to appeal from the order denying the petition filed by the conciliation commissioner.

"The rule in the federal courts is that a person cannot appeal from an order, decree, or judgment who is not a party or privy to the record. U. S. ex rel. State of Louisiana v. Jack, 244 U. S. 397, 402, 37 S. Ct. 605, 61 L. Ed. 1222; Grant v. United States, 227 U. S. 74, 33 S. Ct. 190, 57 L. Ed. 423; Ex parte Leaf Tobacco Board of Trade, 222 U. S.

578, 32 S. Ct. 833, 56 L. Ed. 323; Guion v. Liv. Lond. & Globe Ins. Co., 109 U. S. 173, 3 S. Ct. 108, 27 L. Ed. 895; In re Cockcroft, 104 U. S. 578; Bayard v. Lombard, 50 U. S. (9 How.) 530, 559. One exception to the rule is that, where a person had been treated as a party in the trial court, he may be allowed to appeal." Citing cases. The cases cited by *amicus curiae, Andrews v. Thum* (C. C. A. 5th Cir.), 64 Fed. 149, and *Hinckley v. Gilman C. & S. R. Co.,* 94 U. S. (4 Otto) 467, 24 L. Ed. 166, fall within this exception.

"Obviously appellant was not a party to the proceeding. She was not named as a party petitioner, and was not ordered to show cause. She sought no relief, although the relief sought by a third person would have enured to her benefit. No relief was sought against her.

"Likewise she could not be a privy, for she does not claim any right to an injunction as successor to the rights of the conciliation commissioner. * * *

"Whatever rights were given by the act to the conciliation commissioner were not also given to appellant, and therefore, if the conciliation commissioner had any right to an injunction, appellant did not own that right with him, and did not succeed to it. Thus she is not in privity with him."

The appeal was dismissed.

In the *Matter of Peppers Fruit Co.,* 24 Fed. Supp. 119, the Referee made an order authorizing the Trustee to compromise two suits against officers of the bankrupt which were pending. Creditors holding 169 claims to-

taling $264,873.66 approved the compromise. C. J. Lehman, a creditor with a small claim of $55.00, opposed it. Thereafter, two other creditors who apparently had not appeared at the hearing, joined with Lehman in filing a petition for review. The Trustee moved to dismiss the petition. The District Court said:

> "However, the contention of the trustee that Carpenter Hiatt Sales Company and E. D. Nickerson are not proper parties to the review does appear to be well founded. The Circuit Court of Appeals for the Ninth Circuit, in the case of In re Rose (1936), 32 Am. B. R. (N. S.) 404, 86 F. (2d) 69, held that, under federal practice, no person may appeal from an order, decree, or judgment who is not a party or privy to the record. The court there decided that the bankrupt, in a section 75 proceeding, was not a proper party applicant, since she was not a party to the hearing in the court below. To the same effect see In re Inter-City Trust C. C. A. 1st Cir. 1924), 3 Am. B. R. (N. S.) 566, 295 F. 495. The contrary view seems to be held by the Sixth Circuit in Forsher v. Graham, 14 Am. B. R. (N. S.) 29, 32 F. (2d) 654. This court feels that, in the interest of economy and efficiency of administration of bankrupt estates, reviews from referee's orders, at least those orders which are made after notice, should be limited to applications by parties who have appeared at the hearing before the referee and participated therein. Any other holding would leave the door open to a flood of reviews which would result not only in delay and expense, but would place an almost intolerable burden upon the district judges. This contention of the trustee is, therefore, sustained and the review is dismissed as to Carpenter Hiatt Sales Company and E. D. Nickerson. This leaves C. J. Lehman as the sole reviewing creditor."

The Appellant, if Dissatisfied With His Bargain, or if Any Fraud or Mistake Was Involved Therein, Had a Clear Remedy by Rescinding His Contract Promptly Upon Discovery, Returning What He Had Bought to the Trustee Who Succeeded the Receiver Instead of Contumaciously Refusing to Pay the Purchase Price but Retaining the Fruits of the Transaction.

One of the grounds relied on by the District Court in reversing the order of the Referee confirming this compromise was the defiant attempt on the part of appellant to refuse to pay the purchase price stipulated, and yet at the same time retain the fruits of his bargain. Even assuming that appellant did not know within ten days after the confirmation of the sale that a shortage existed in bottles and cases, upon discovery of this alleged shortage it still had its remedy. The transaction took place in the State of California. Section 1691 of the Civil Code of California provides as follows:

> "Rescission, when not effected by consent, can be accomplished only by the use, on the part of the party rescinding, of reasonable diligence to comply with the following rules:
>
> "1. He must rescind promptly, upon discovering the facts which entitle him to rescind, if he is free from duress, menace, undue influence, or disability, and is aware of his right to rescind; and,
>
> "2. He must restore to the other party everything of value which he has received from him under the contract; or must offer to restore the same, upon condition that such party shall do likewise, unless the latter is unable or positively refuses to do so."

In the case at bar, appellant bid the assets of this going business in at a judicial sale held before the Referee

on Wednesday, October 15, 1947 [Tr. pp. 50, 71]. The written order confirming the sale was signed seven days later, October 22, 1947, and covered the physical assets of every class and character of the Yankee Doodle Root Beer Company as of October 15, 1947 [Tr. p. 5]. It is evident from the discussion at page 70 of the transcript that possession was given the night of October 15, the date of the sale. The second highest bid at its judicial sale was made by Mr. Miller in the amount of $160,000.00 and was raised by appellant to $161,000.00 [Tr. p. 68]. If appellant claimed that it was entitled to the cases and bottles which were out of the possession of the bankrupt corporation, which were not in the possession of the Receiver and never had been, and on which credit would be given, when returned in connection with future orders of this going business which appellant purchased, and the Receiver was either unable to deliver or had misrepresented to appellant, appellant's remedy was by prompt rescission. A receiver or trustee in bankruptcy is not so sacrosanct that if he is guilty of overreaching a purchaser at a judicial sale, the purchaser has no right of rescission. Indeed, it has been held that notwithstanding the Trustee's title to property in the possession of the bankrupt as a junior lienholder thereof, or as an execution creditor with his execution returned wholly unsatisfied under Section 70-a of the National Bankruptcy Act, a seller who has been defrauded by the bankrupt may assert his right of rescission against the Trustee.

In *Jones v. Hobbie Grocery Co.,* 246 Fed. 431 (U. S. Court of Appeals, Fifth Circuit) in a case where a bankrupt a few days prior to filing his voluntary petition in bankruptcy purchased merchandise from the appellee knowing of his insolvency and with no reasonable

expectation of being able to pay for it, held that the defrauded vendor was entitled to reclamation. In that case the Referee apparently granted the petition in reclamation which was affirmed by the District Court. On appeal by the Trustee, in affirming the lower Court, the Court of Appeals said:

> "If * * * the sale was induced by false or fraudulent representations as to his financial condition on which the seller relied, or would not have been made but for his fraudulent concealment of his financial condition or of the fact that he did not intend to pay or reasonably expect to be able to pay for the goods, the seller has the right to rescind the sale and recover his property. Maxwell v. Brown Shoe Co., 114 Ala. 304; Donaldson v. Farwell, 93 U. S. 631.
>
> "The seller's petition in the pending case, and the evidence adduced in support of it, we think sufficiently show that, as against the purchaser, he had the right, under the rule just stated, to rescind the sale and recover the goods sold. It is contended in behalf of the appellant that this right does not exist against him, the purchaser's trustee in bankruptcy. This contention is sought to be supported by invoking the provision of the Bankruptcy Act that 'such trustees, as to all property in the custody or coming into the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies and power of a creditor holding a lien by legal or equitable proceedings thereon.' Bankruptcy Act §47a(2), as amended by Act of June 25, 1910.
>
> "The contention stated cannot prevail unless under the Alabama law the right conferred on the purchaser's creditor by the acquisition of a lien on the latter's property by legal or equitable proceedings is

superior to that of the defrauded seller to rescind the sale and reclaim the goods sold. In our opinion that superiority does not exist under the Alabama law.

"The judgment is affirmed."

Bearing in mind that this sale took place in California, we refer the Court to *Russell v. Penniston,* 55 Cal. App. 492, at page 495, where the Court said:

> "Neither was the plaintiff entitled to a judgment of rescission because he was in default at the time he claimed he attempted to rescind. (Fairchild etc. Co. v. Southern etc. Co., 158 Cal. 264, 273 (110 Pac. 951.) Furthermore, he was not entitled to rescind except that he complied with the provisions of section 1691 of the Civil Code, and the findings are to the effect that he did not do so."

We submit that under the Fourth Circuit decision just cited, if a trustee were subject to rescission by reason of the fraud of his predecessor, the bankrupt, how much more so would the Receiver be, both under California law and under the Bankruptcy Act, to rescind in the event he had deceived or misled the purchaser at a judicial sale conducted by him. If, as contended here by appellant, it bid on this going business in competition with other prospective purchasers in the sum of $161,000.00 under the mistaken belief induced either by the silence or affirmative fraud of the Receiver that it would receive 25,000 cases of empty bottles which were scattered all over Los Angeles and vicinity in the possession of customers, then his remedy was to promptly rescind, petition the Court for vacation of the order of confirmation, restore or offer to restore to the Receiver the going business which he had purchased and receive back from the Receiver and the Court the purchase price which he had theretofore paid.

The record in this case can be searched from beginning to end, and nowhere will there be found any offer on the part of appellant to turn back its going business to the Court and take its money back. On the contrary, it sought to have its cake and eat it by coming in and whining to the Receiver, the Referee and the creditors several weeks after the confirmation of the sale, that it understood that among the assets it was acquiring were these widely scattered cases which would come back into its possession upon sale of new cases of filled bottles, and that it was now entitled to a substantial reduction of the $161,000.00 purchase price which it had agreed to pay. It cannot be said that this appellant went out from the Court secure in the belief that it was getting these scattered bottles and cases in its purchase. That such was not the case is clearly evident from the statement made by Mr. Gendel, the then attorney for the Receiver, commencing at page 68 of the transcript, while Mr. Katz, attorney for the purchaser was present and participated in the colloquy. At page 68 of the transcript, after the Referee had announced "sold for $161,000.00 to the Wil-Rud Corporation, Mr. Gendel, in order that there could be no misunderstanding, made this statement at pages 68 and 69 of the transcript:

> "May I on behalf of the Receiver make a closing statement in connection with what I understand the Receiver wants to confirm as part of the sale so that there is no question.
>
> "The Receiver is selling to the buyer all of his right, title, and interest in and to the lease of the premises in question occupied by the debtor corporation. * * * The Receiver is selling the machinery, *equipment,* and fixtures located at the place of business of the California Associated Products

> Co., *3631 Union Pacific Avenue,* and the inventory *as is now* subject only to the balance owing on the water softener of $1699.17." (Italics ours.)

At the bottom of page 69, Mr. Katz, attorney for the appellant, participated in this discussion. Manifestly, the equipment located at the place of business of California Associated Products Co., 3631 Union Pacific Avenue, could not and did not include the widely scattered cases of empty bottles in the hands of customers unless all of those customers were located at No. 3631 Union Pacific Avenue, and we do not think that any such contention will be made. If it were intended that these cases and bottles were to be included in the purchase, then was the time for Mr. Rudolph to have spoken up on behalf of the successful bidder, and, in the event of misunderstanding as to the location of the equipment, withdrawn his bid of $161,000.00 or had the matter clarified, and in any event, the Receiver could then have fallen back on the pre-existing $160,000.00 bid made by Mr. Miller. The bankrupt estate would have suffered only to the extent of $1,000.00 at the most and everyone would have been happy. As it was, the competing bidders were allowed to disperse, the $160,000.00 bid was lost, appellant took over the business and later sought to improve its position by refusing to pay the balance of the purchase price. This it cannot do.

In the *Matter of Union Co-op. Bakery,* 4 F. 2d 435, a purchaser of real property from a Receiver for the sum of $10,000.00 which was confirmed, sought to vacate the sale. His petition was denied. The purchaser in that case had bought the property on September 17. He made no objection after confirmation thereof until November 1st. The order refusing to permit him to withdraw was affirmed.

In *Hall v. McGehee,* 37 F. 2d 854, the trustee negotiated a private sale of a business he had been operating and out of which some of the merchandise had been sold. The purchaser submitted a bid wherein he agreed to pay sixty cents on the dollar for the merchandise, office and warehouse furniture and fixtures, and the automobile equipment on the basis of the appraised value covering items as shown on the inventory. He knew at the time he submitted his bid that some of the inventoried goods had been sold and that there would be a joint check of the inventory between the purchaser and the Trustee. The check revealed a shortage of $2,677.43 which was accepted by the Referee. The purchaser tendered a check to the Trustee which was in an inadequate amount to cover the balance, disputing the inventory checked figures. The Referee made an order requiring the purchaser to pay the full amount claimed by the Trustee. That order was reversed by the District Court and on appeal the Court of Appeals for the Fifth Circuit said:

> "If the appellee was dissatisfied with his purchase because of the shortage, he could have asked the court not to confirm the sale, and to rescind the transaction. On the contrary, he sought its confirmation and paid part of the purchase money, with knowledge of the shortage, after it had been confirmed. Under these circumstances, the utmost he could have asked in equity would have been a proportionate abatement of the purchase money, and this the referee gave him, based on his own estimate of the amount of goods that were short. (Citing cases.)
>
> "Appellee knew he was buying at a judicial sale, at which the rule of *caveat emptor* applied. In re The Monty Allegre, 9 Wheat. 616, 6 L. Ed. 174; Carney v. Averill, 110 Me. 172, 85 A. 494; John Schaap Drug Co. v. Rone (C. C. A.), 19 F. (2d) 517. He

also had actual knowledge that a part of the merchandise had been sold after it had been inventoried, and agreed with the trustee upon a joint check for that reason. Even if the trustee failed to deliver the amount inventoried, the appellee, having knowingly bid for and received the unsold part of the merchandise, and having asked a confirmation of the sale on this partial basis, cannot assert that the contract of sale was broken thereby. The transaction would constitute a sale of only what was left of the stock. The appellee himself testified, 'We bought what was down there,' and the trustee was due to deliver no more.

"The conclusion reached requires the reversal of the order of the District Court and the remand of the case for further proceedings in conformity with the order of the referee; and it is so ordered."

In the case at bar, much the same situation existed. In the petition for order to show cause against Wil-Rud Corporation [Tr. p. 8] the Receiver sets up as of October 31, 1947, that the appellant had paid the sum of $100,000.00 on the purchase price. In his petition to compromise the controversy, appearing at page 14 of the transcript, is the figure of a credit for $125,000.00 in favor of appellant. In the interim between October 31, 1947, and the date of the petition to compromise, December 26, 1947, this appellant had paid the Receiver an additional $25,000.00 of the purchase price with full knowledge of the facts as they existed.

It is also highly significant that in the case at bar, Sam Rudolph, who did the bidding for appellant at its sale, when put on the stand by Mr. Katz, at page 169 of the transcript at no time testified that he had bought this going business in reliance on an inventory taken several

months before. He simply testified that he had examined page 88-a of the inventory and that the Receiver had not made delivery to him of the items listed on page 88a. He did not say "I relied on the inventory taken several months before; I bought on that inventory" but merely testified that he had examined it.

On the contrary, Rudolph's testimony on behalf of appellant is replete with statements which indicate that he was not relying on the inventory nor that any agreement existed for rectifying shortages which would naturally occur in this going operating business. We quote some of these statements made by Mr. Rudolph:

> "We took for granted an inventory taken by the Receiver or Trustee is always correct and we have bought goods for the last twenty-five or thirty years and we don't do a lot of checking when we go in and look at an inventory because we know when they check an inventory it is correct. They do make allowances when they are short or over. The reason we didn't pay the balance of the $161,000.00, we wanted to check and see if they were going to make good. We checked it once and they were dissatisfied and we had another man go over and make the second check." [Testimony of Sam Rudolph, p. 100.]

> "Q. What is it you say Mr. Yates told you about the shortages? A. Mr. Yates did not say anything about shortages. He said, 'You understand that they sold the Monterey grape juice.' In going through the plant there was a lot of cases of grape juice.
>
> Q. I just asked what he said to you. A. I am telling you.
>
> Q. About the subject matter of shortages. A. The only thing he told me was sold at that time was the Monterey grape juice.

Q. That is all Mr. Yates told you? A. Yes." [Tr. p. 102.]

"Q. What did Mr. Yates say with reference to the subject matter of making good? A. I never said anything about him making good at all. I didn't make any such statement about him making good. We were just checking the inventory at the time.

Q. I see. A. Don't misunderstand. He didn't say he would make anything good.

Q. He didn't say the Receiver would make anything good, did he? A. He said, 'We were going to check it.'

Q. All he said, 'We are going to check out the inventory,' is that it? A. That is correct." [Tr. p. 103.]

In the *Matter of Solantkias,* 33 F. 2d 200, the Court said at page 201:

"We concur in the views expressed by the referee that Diamond had no right to withhold the payment of the $3,500.00 on account of alleged discrepancies between the inventory and the goods actually turned over by the receiver to Diamond. This was a judicial sale to which the rule of *caveat emptor* clearly applied. If a fraud be practiced upon the purchaser at a public sale, he should immediately ask to have the sale set aside and return the property. The court could then give him the relief to which he is entitled. He could not adjust that matter himself by withholding a part of the purchase money."

Conclusion.

It is clearly evident that this appellant is only seeking here to attenuate a purchase price at a judicial sale in a deal which it may have found unprofitable. What has become of the assets which this appellant obtained from the Receiver on his bid of $161,000.00, we do not know. We do know, however, that it has not returned them to the Receiver nor has it offered to do so. Were such the case, appellant would have some equitable standing before this Court. Instead, it ignored the petition for review taken by protesting creditors as petitioners on review and the Receiver as respondent and now seeks to inject itself before this Court as an appellant from the reversal of an order which affected the Receiver or creditors only. This it cannot do.

See: *In re Bender Body Company,* 139 F. 2d 128.

At the time this petition to compromise was submitted by the Receiver and recommended, the Receiver and his then counsel believed in good faith that a compromise was better than a lawsuit. However, at the hearing in confirmation of the compromise, there was most decided objection on the part of the majority of creditors in amount, and of all the creditors present and voting save one who was more or less noncommittal [Tr. pp. 165-166].

Notwithstanding the vigorous objection of these large creditors, the Referee overruled their protests, and convinced that this compromise was not to the best interests of this estate, and their money being involved, these credi-

tors went to the expense of procuring a transcript and taking the matter up on review. The District Judge, after analyzing the matter, wrote his opinion reversing the Referee's order. The District Judge, in writing this opinion, was apparently very strongly impressed with this appellant's effort to retain the advantages of his bargain, together with the refund sought through the compromise [Tr. p. 43] and the fact that appellant made no effort to rescind and return the property [Tr. p. 40]. The appellant has never offered to restore the consideration to the estate, and we respectfully submit that the judgment of the District Court should be affirmed.

Dated: March 30, 1950.

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